LEBANON BANKING SECTOR REPORT

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MAINTAINING A THOROUGH OVERALL RISK PROFILE WITHIN A TOUGH OPERATING ENVIRONMENT

- **Activity growth slowdown though remaining adequate**
  While Lebanon's consolidated banking activity slowed down in 2015, its growth remains adequate on the overall, hovering around the mid single-digit levels. Measured by their consolidated assets, Lebanese banks activity grew by 4.8% between December 2014 and December 2015, with assets reaching US$ 227.8 billion at year-end. While domestic growth reported 5.1%, foreign growth reported a slower growth of 3.4% in 2015. Consolidated customer deposits, which represent 81.8% of consolidated assets, grew at a modest rate of 4.5% in 2015. In parallel, consolidated loans to the private sector grew by 5.6% in 2015, almost half their growth in the previous year, with the slowdown mainly attributed to foreign loans.

- **High liquidity levels highlighting strong financial flexibility**
  Lebanese banks maintained their highly liquid status in 2015. Their net primary liquidity as a percentage of deposits registered 30.7% at end-December 2015. The low loans to deposits ratio of 39.0% continues to bear witness to the strong financial flexibility in Lebanese banks.

- **Slight improvement in asset quality despite tough operating conditions**
  The ratio of doubtful loans to gross loans dropped from 6.6% in 2014 to a record low over the past decade of 6.4% in 2015, below emerging markets and global benchmarks. The prudent provisioning policies of Lebanese banks prompted them to take all needed measures to maintain their good asset quality. At the current 75.6% level, the coverage of doubtful loans by loan loss provisions continues to be adequate.

- **Reinforced capital adequacy status**
  Lebanese banks' shareholders' equity grew by 6.8% over the past year to reach US$ 21.0 billion at end-December 2015. With asset growth lagging behind the growth in shareholders' equity, the equity-to-asset ratio rose to 9.2% in December 2015, providing banks adequate capital cushions within the context of a challenging operating environment. The total Basel II capital adequacy ratio reported 15.0% at end-December 2015, well exceeding requirements and reflecting an adequate coverage of the aggregation of credit, market and operational risks.

- **Growing profitability but return ratios remain modest**
  The consolidated net profits of Lebanese banks expanded by 7.0% in 2015 to reach US$ 2.2 billion. The banking sector's return ratios were almost stable in 2015, as growth in the sector's net profits was only marginally above growth in assets and equity. The sector's return on average assets was 0.99% in 2015, unchanged from the previous year, while the return on average equity stood at 10.83% compared to 11.0% in 2014. It is worth noting that Lebanon's return ratios came, again this year, somewhat short of global benchmarks.

- **Well positioned today to take advantage of any trend reversal in domestic or regional markets**
  Lebanese banks' strong financial fundamentals, their well diversified activity profile, their innovative management philosophies, their pioneering services and product mix, all put them in an adequate position to reap the benefits of a pent-up demand for financial services in a number of markets of presence alongside those of a lucrative domestic market at large.

The following banking sector research is based on "consolidated" Lebanese banking figures as at end-2015 as provided by Bankdata Financial Services. It aims at an in-depth analysis of Lebanon's banking industry, with a thorough investigation of banks' performance drivers, their current financial standing and their overall risk profile.

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CONSOLIDATED ACTIVITY GROWTH

Lebanese banks witnessed a slowdown in consolidated activity growth in 2015, though the latter remains at acceptable levels. As a matter of fact, measured by their consolidated assets, Lebanese banks activity grew by 4.8% between December 2014 and December 2015, with assets reaching US$ 227.8 billion at year-end. Such a growth remains lower than the 9.3% reported in 2014 and the 9.6% reported in 2013. In particular, while domestic growth reported 5.1%, foreign growth reported a slower 3.4% in 2015, impacted by the depreciation of emerging markets currencies relative to the US$, of which those of the countries of presence of Lebanese banks outside Lebanon. It is important to mention that 71.1% of Lebanese banks branches are located in Lebanon and 28.9% abroad, while 72.3% of staff is located in Lebanon and 27.7% abroad.

Consolidated customer deposits, which represent 81.8% of consolidated assets, grew at a modest rate of 4.5% in 2015. The US$ 8.0 billion growth in consolidated deposits in 2015 proved 43% lower than that of the year 2014, and 37% below that of the last five years. The geographic breakdown suggests that domestic deposits grew by 5.1% and foreign deposits grew by 1.7% in 2015. The growth in domestic deposits remains yet sufficient to finance the domestic economy in its private and public components. At the level of the breakdown by currency, with foreign currency deposits growing at a lower rate than LL deposits (3.3% and 7.3% respectively), the deposit dollarization ratio reached a near three-year low of 69.5% at end-2015, against 70.3% at end-2014.

In parallel, consolidated loans to the private sector grew by 5.6% in 2015, almost half their growth in the previous year, with the slowdown mainly attributed to foreign loans. As a matter of fact, while foreign

GROWTH RATES OF BANKING AGGREGATES

	2010	2011	2012	2013	2014	2015	Var 15/14
Assets	11.9%	7.9%	8.4%	9.6%	9.3%	4.8%	-4.5%
Loans to customers	25.2%	13.6%	11.4%	15.1%	11.0%	5.6%	-5.4%
Customer deposits	12.4%	7.4%	8.8%	9.6%	8.5%	4.5%	-4.0%
Shareholders' equity	15.9%	1.9%	13.4%	8.5%	10.8%	6.8%	-4.0%
Annual L/C openings	31.2%	-8.4%	-5.3%	-5.8%	1.5%	-21.0%	-22.5%
Net profits for the year	28.4%	-4.7%	7.6%	0.2%	9.1%	7.0%	-2.1%

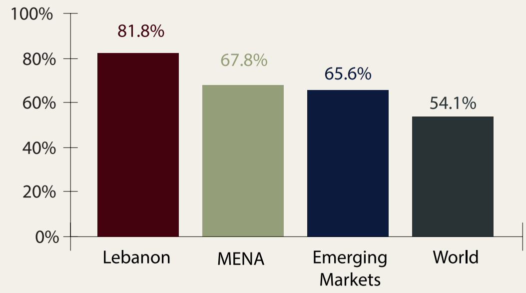
Source: Bankdata Financial Services wll

GROWTH RATES OF LEBANESE BANKS' GROUPS (YEAR 2015)

	Alpha	Beta	Gamma	Delta
Assets	4.7%	5.7%	-1.6%	5.5%
Loans to customers	5.9%	2.7%	4.7%	7.8%
Deposits from customers	4.6%	4.6%	0.1%	-1.2%
Shareholders' equity	6.0%	16.7%	11.2%	5.5%
Total L/C openings of the year	-19.2%	-6.8%	-44.1%	-72.9%
Net profits for the year	8.3%	-9.2%	152.5%	-26.7%

Source: Bankdata Financial Services wll

DEPOSITS/ASSETS RATIOS (YEAR 2015)



Sources: Bankdata Financial Services, IMF, Bankscope, Fitch, MENA Central Banks

loans grew by 2.8%, domestic loans to the private sector grew by 6.6% in 2015, partly supported by the stimulus package of the Central Bank for the third consecutive year. The low loans to deposits ratio of 38.96% continues to bear witness to the strong financial flexibility in Lebanese banks.

The analysis by group of banks according to their size shows that growth was realized at different paces by the different bank groups. Bilanbanques divides the banking sector into four groups by size, the first being the Alpha Group (Banks with customer deposits above US$ 2 billion), then the Beta Group (Banks with customer deposits between US$ 500 million and US$ 2 billion), then the Gamma Group (Banks with customer deposits between US$ 200 million and US$ 500 million) and finally the Delta Group (Banks with customer deposits below US$ 200 million). The fastest activity growth in 2015 was realized by the group of medium-sized banks, with the Beta group displaying a growth rate of 5.7%, while the Alpha Group reported a growth of 4.7%, the Delta Group grew by 5.5% and the Gamma Group contracted by 1.6%.

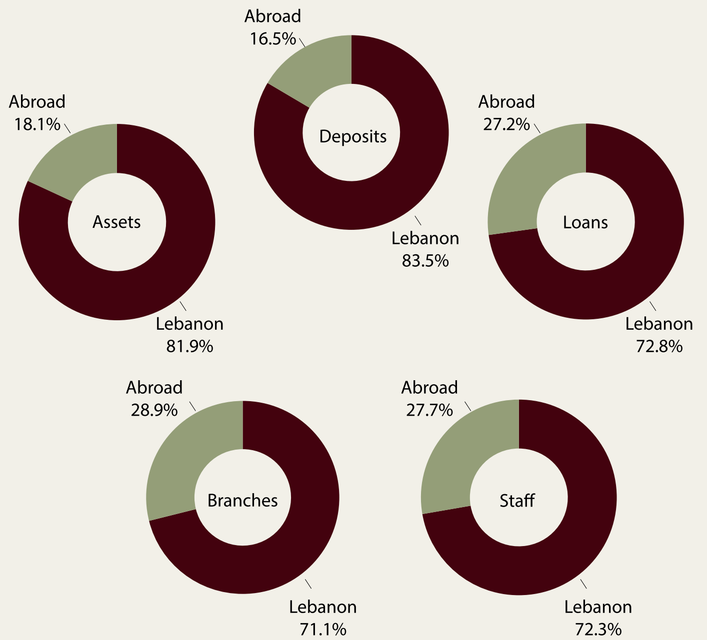
But banking activity continues to be significantly concentrated, with no significant changes in the shares of the different bank groups. The Alpha Group's share remains highly dominant at 89.4% of the sector's consolidated assets (89.5% in 2014), followed by the Beta Group with 8.2% (8.1% in 2014), the Delta Group with 1.7% (1.7% in 2014) and the Gamma Group with 0.6% (0.7% in 2014).

The analysis of Lebanese banks groups by dollarization ratios suggests that the group of small banks is the most dollarized in terms of deposits and the least dollarized in terms of loans. Deposit dollarization stands at 72.3% for the Delta Group, followed by 70.0% for the Alpha Group, 64.5% for the Beta Group and 62.9% for the Gamma Group. On the other hand, loan dollarization is the largest for the Alpha Group with 81.9%, followed by 73.6% for the Beta Group, 64.3% for the Gamma Group, and 50.6% for the Delta Group.

LIQUIDITY AND SOVEREIGN EXPOSURE

Lebanese banks maintained their highly liquid status in 2015. Their net primary liquidity as a percentage of deposits registered 30.69% at end-December 2015, with the primary liquidity ratio in foreign currency registering 36.68% while the primary liquidity ratio in Lebanese Pounds reported 17.03%. It is yet worth mentioning that the breakdown of liquidity suggests a further decline in liquidity in foreign banks which reported 8.75% of assets while liquidity at the Central Bank reported 22.29% of assets at year-end 2015.

GEOGRAPHIC CONCENTRATION (YEAR 2015)



Source: Bankdata Financial Services wll

Part of banks' excess liquidity actually went to Tbs subscriptions, as the government was seeking funds to cover up its deficit and banks wanted to maximize return on investments. Banks subscribed to the latest Eurobond issuance that took place in the last quarter of 2015, leading to a slight uptick in Lebanese sovereign exposure in FC as a percentage of total equity (87.55% in 2015 against 85.98% in 2014). The latter measure yet remains nearly twice lower than a few years ago when the ratio was crossing the 200% mark, thus showing banks' relatively easing exposure to sovereign debt.

The analysis of liquidity by Lebanese banks' groups in 2015 shows that liquidity is almost inversely related to the size of banks. The most liquid group is the Gamma Group with a net primary liquidity to deposits ratio of 35.86%, followed by the Alpha Group with a ratio of 31.45%, then the Beta Group with a ratio of 26.23%, and the Delta Group with a negative ratio of -17.34% as it holds a significantly large amount of government paper among its asset base.

The analysis of sovereign exposure by Lebanese banks' groups in 2015 shows that the group with the highest exposure in Lebanese Pounds is the Delta Group with a ratio of Lebanese Treasury bills in LL to deposits in LL of 88.25%, followed by the Beta Group with 46.53%, the Gamma Group with 39.77% and the Alpha Group with 34.70%. In parallel, the group with the highest exposure in foreign currency in 2015 is the Delta Group with a ratio of Lebanese sovereign eurobonds to deposits in foreign currency of 51.60%, followed by the Gamma Group with 18.54%, the Beta Group with 15.06% and the Alpha Group with 13.79%.

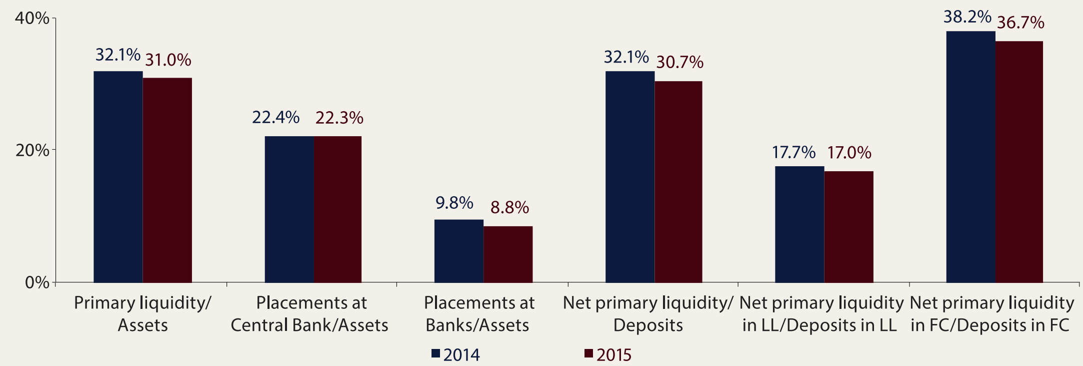
As such, sovereign exposure seems to be almost inversely related to the size of banks. However, the large banks tend to have large Central Bank exposure in relative terms. As a percentage of their asset base, placements at the Central Bank represent 23.81% for the Gamma Group, followed by the Alpha Group with 22.88%, the Beta Group with 17.36% and the Delta Group with 14.66%.

LIQUIDITY OF LEBANESE BANKS' GROUPS (YEAR 2015)

	Alpha	Beta	Gamma	Delta
Primary liquidity/Assets	**31.4%**	**26.5%**	**33.4%**	**34.1%**
o.w. Central Bank/Assets	22.9%	17.4%	23.8%	14.7%
o.w. Banks/Assets	8.5%	9.2%	9.6%	19.4%
Net primary liquidity/Deposits	**31.5%**	**26.2%**	**35.9%**	**-17.3%**
o.w. Net primary liquidity in LL/Deposits in LL	18.0%	10.5%	35.1%	-33.8%
o.w. Net primary liquidity in FC/Deposits in FC	37.2%	34.9%	36.3%	-11.0%

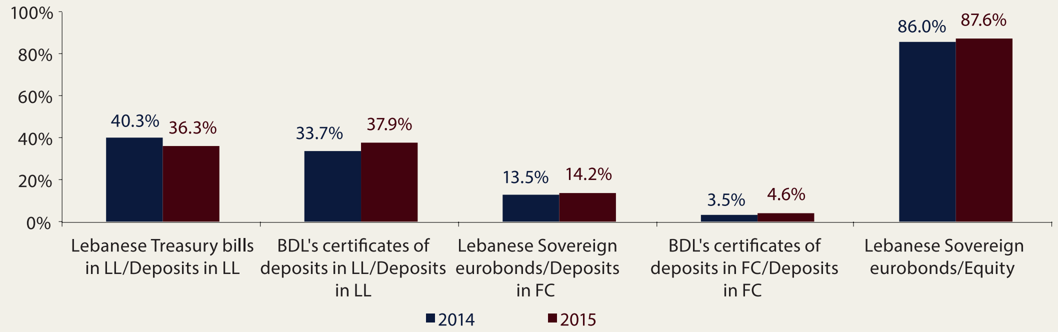
Source: Bankdata Financial Services wll

LIQUIDITY OF LEBANESE BANKS



Source: Bankdata Financial Services wll

SOVEREIGN EXPOSURE OF LEBANESE BANKS



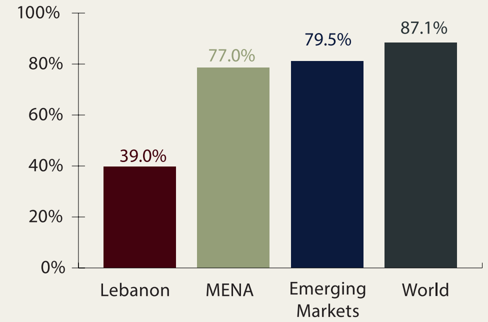
Source: Bankdata Financial Services wll

SOVEREIGN EXPOSURE OF LEBANESE BANKS' GROUPS (YEAR 2015)

	Alpha	Beta	Gamma	Delta
Lebanese Treasury bills in LL/Deposits in LL	34.7%	46.5%	39.8%	88.3%
BDL's certificates of deposits in LL/Deposits in LL	40.0%	21.5%	20.2%	21.4%
Lebanese Sovereign eurobonds/Deposits in FC	13.8%	15.1%	18.5%	51.6%
BDL's certificates of deposits in FC/Deposits in FC	4.7%	3.1%	1.9%	6.6%
Lebanese Sovereign eurobonds/Equity	89.3%	90.2%	64.3%	53.1%

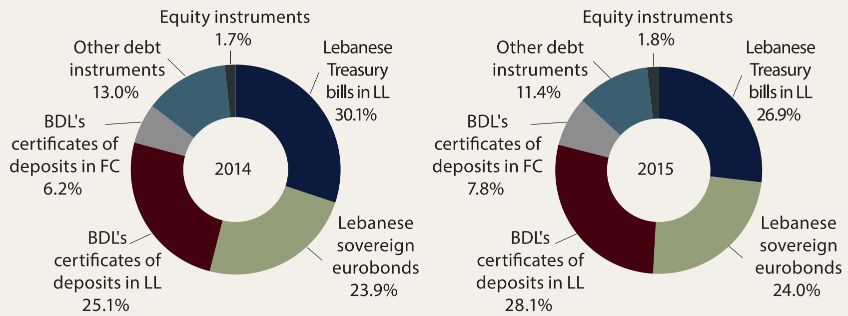
Source: Bankdata Financial Services wll

LOANS/DEPOSITS (YEAR 2015)



Sources: Bankdata Financial Services, IMF, Bankscope, Fitch, MENA Central Banks

PORTFOLIO SECURITIES BREAKDOWN



Source: Bankdata Financial Services wll

LENDING QUALITY AND PROVISIONING

On the lending front, activity slowed down further in 2015, amidst sluggish economic conditions in the country and weak lending opportunities domestically and regionally. As a matter of fact, Lebanese banks reported last year a moderate 5.6% increase in lending activity, with total net loans reaching a new high of US$ 72.6 billion at end-December 2015 yet progressing at a slower pace when compared to an 11.0% growth in 2014. The US$ 3.8 billion increase in lending volumes during 2015 compares to a US$ 6.8 billion increase during 2014. The growth in total loans was attributed to foreign currency loans to the extent of 63% in 2015, down from 77% in 2014, which leaves US$ 1.4 billion in additional lending volumes last year tied to loans in local currency. This falls in line with the trend observed over the previous few years when Lebanese banks, encouraged by the Central Bank's measures aimed at fostering local currency lending, increased their share of LP loans in the total. It is worth mentioning that the breakdown of bank loans by type of borrower reveals that corporates accounted for 40.6% of loans extended in 2015, followed by SME loans with 15.6% and housing loans with 14.8%.

Despite the prevailing climate in Lebanon and in the main regional markets of presence, asset quality reported a slight improvement over the past year. The ratio of doubtful loans to gross loans dropped from 6.55% in 2014 to a record low over the past decade of 6.37% in 2015, which is higher than the regional average of 3.6% but in line with emerging markets and global benchmarks of 6.8% and 7.1% respectively. The prudent provisioning policies of Lebanese banks prompted them to take all needed measures to maintain their good asset quality. At the current 75.56% level, the coverage of doubtful loans by loan loss provisions continues to be adequate, although lower than its previous year's level of 77.31%. It is important to mention that the ratio of net doubtful loans to gross loans stood at 1.56% reaching 2.31% when including substandard loans, which still compares favorably to international benchmarks. As to collective provisioning, the ratio of collective provisions to net loans maintained a sound 1.09% level by end 2015.

The analysis by group of banks suggests the Gamma Group reported the lowest doubtful loans to gross loans ratio of 4.99%, followed by the Alpha Group with 5.51%, the Beta Group with 8.21% and the Delta Group with 31.45%. But when adding substandard loans, the ratio of doubtful and substandard loans to gross loans reported a low of 6.23% for the Alpha Group, 7.12% for the Gamma Group, 10.85% for the Beta Group and 32.78% for the Delta Group. On the other hand, small sized banks were the best provisioned, as the ratio of loan loss reserves on doubtful loans as a percentage of doubtful loans reported high ratios of 80.77% for the Delta Group, while the Beta Group registered a ratio of 78.07% and the Gamma and Alpha Groups recorded a ratio of 74.81% and 74.35% respectively.

BREAKDOWN OF LOANS AND ADVANCES TO CUSTOMERS (% OF TOTAL LOANS) IN 2015

	All Banks	Alpha Group	Beta Group	Gamma Group	Delta Group
Corporate	41%	40%	49%	41%	33%
SMEs	16%	16%	16%	30%	2%
Housing	15%	14%	13%	6%	48%
Retail	12%	12%	12%	7%	7%
Secured by commercial real estate	9%	9%	10%	10%	0%
Other loans	8%	8%	1%	5%	9%
Public sector	1%	1%	0%	-	-

Source: Bankdata Financial Services wll

ASSET QUALITY OF LEBANESE BANKS

	2010	2011	2012	2013	2014	2015	Var 15/14
Doubtful loans/Gross loans	7.3%	6.9%	7.1%	6.8%	6.6%	6.4%	-0.2%
Substandard loans + doubtful loans/Gross loans	8.2%	7.7%	7.8%	7.8%	7.4%	7.3%	-0.1%
Net doubtful loans/ Gross loans	1.2%	1.3%	1.4%	1.5%	1.5%	1.6%	0.1%
Loan loss reserves on doubtful loans/Doubtful loans	83.2%	81.8%	79.6%	78.3%	77.3%	75.6%	-1.8%
Net doubtful loans/Equity	4.0%	4.6%	5.1%	5.5%	5.5%	5.7%	0.2%

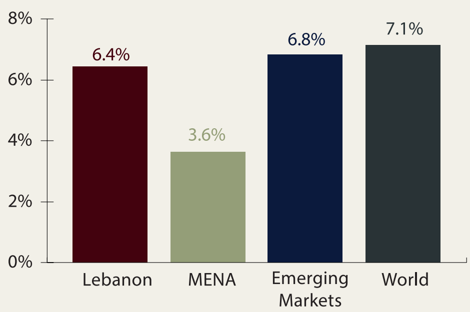
Source: Bankdata Financial Services wll

ASSET QUALITY OF LEBANESE BANKS' GROUPS (YEAR 2015)

	Alpha	Beta	Gamma	Delta
Doubtful Loans/Gross loans	5.5%	8.2%	5.0%	31.4%
Substandard Loans + Doubtful Loans/Gross loans	6.2%	10.9%	7.1%	32.8%
Net Doubtful Loans/Gross loans	1.4%	1.8%	1.3%	6.0%
Loan Loss Reserves on Doubtful Loans/Doubtful Loans	74.4%	78.1%	74.8%	80.8%
Net Doubtful Loans/Equity	5.2%	8.1%	3.3%	11.7%

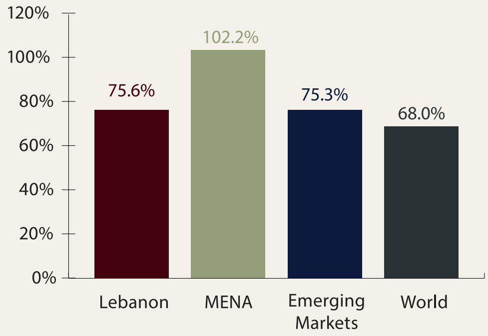
Source: Bankdata Financial Services wll

NPLs/TOTAL LOANS (YEAR 2015)



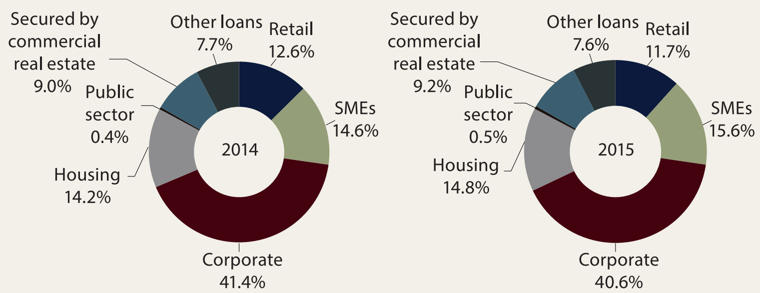
Sources: Bankdata Financial Services, IMF, Bankscope, Fitch, MENA Central Banks

LLRs/NPLs (YEAR 2015)



Sources: Bankdata Financial Services, IMF, Bankscope, Fitch, MENA Central Banks

LOANS AND ADVANCES BREAKDOWN



Source: Bankdata Financial Services wll

CAPITAL ADEQUACY AND SOLVENCY

The Lebanese banking sector continued to reinforce its capitalization status in 2015. Lebanese banks' shareholders' equity grew by 6.8% over the past year, moving from US$ 19.7 billion at end-December 2014 to US$ 21.0 billion at end-December 2015, though lower than the 10.8% growth reported in 2014.

With asset growth lagging behind the growth in shareholders' equity, the equity-to-asset ratio slightly moved from 9.05% in December 2014 to 9.22% in December 2015, providing banks adequate capital cushions within the context of a challenging operating environment and banks' credit exposure to the sovereign. A related measure is the ratio of shareholders' equity to net loans which stood at 28.9% for Lebanon's banking sector at end-2015 against a regional average of 22.9%, an average of 15.2% in emerging markets and an average of 14.8% at the global level. Mirroring Lebanon's banking sector capitalization is the leverage ratio of average assets to average equity, which declined from 11.12 in 2014 to 10.94 in 2015.

Lebanese banks remained indeed adequately capitalized. The total Basel II capital adequacy ratio reported 15.03% at end-December 2015 as compared to 14.60% at end-December 2014, well exceeding requirements and reflecting an adequate coverage of the aggregation of credit, market and operational risks. The sound capital adequacy ratio in 2015 comes within the context of a 7.9% growth in total capital against a 4.9% growth in risk-weighted assets amid a rising share of risk-weighted assets in total assets from 54.6% in 2014 to 54.7%. The total capital ratio is the result of a total capital of US$ 18.9 billion against a total of risk weighted assets of US$ 124.6 billion. It is worth mentioning that the total capital ratio is broken down into a Tier 1 ratio of 13.88% and a Tier 2 ratio of 1.30%. In turn, the Tier 1 ratio consists of a 10.99% common Tier 1 ratio and a 2.89% additional Tier 1 ratio. The sustained improvement in Lebanese

CAPITALIZATION OF LEBANESE BANKS

	2010	2011	2012	2013	2014	2015	Var 15/14
Capital adequacy (as per Basel II requirements)	13.0%	11.8%	13.8%	14.2%	14.6%	15.0%	0.4%
Equity to assets	9.1%	8.5%	9.0%	8.9%	9.1%	9.2%	0.2%
Leverage (times)	11.1	11.4	11.3	11.1	11.1	10.9	-0.2

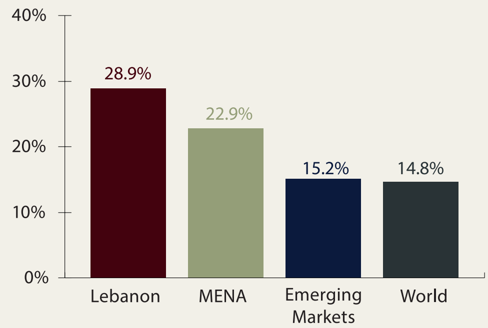
Source: Bankdata Financial Services wll

CAPITALIZATION OF LEBANESE BANKS' GROUPS (YEAR 2015)

	Alpha	Beta	Gamma	Delta
Capital adequacy (as per Basel II requirements)	14.6%	14.8%	22.3%	30.7%
Equity/Assets	8.9%	9.0%	14.0%	23.4%
Leverage (times)	11.3	11.6	7.6	4.3

Source: Bankdata Financial Services wll

EQUITY/NET LOANS (YEAR 2015)



Sources: Bankdata Financial Services, IMF, Bankscope, Fitch, MENA Central Banks

banks' capital ratios is partly driven by a regulatory change in 2014 that reduced the risk-weighting of banks' foreign currency exposures with the BDL to 50% from 100%, while keeping the local currency exposures risk-weighted at zero.

A closer look at individual bank groups shows that smaller banks are better capitalized than larger banks relative to the risk weighted size of their activity. Capital adequacy (as per Basle II requirements) reported a high of 30.73% for the Delta Group, followed by a ratio of 22.32% for the Gamma Group, 14.82% for the Beta Group and 14.63% for the Alpha Group in 2015. Likewise, the equity to assets ratio is the highest for the Delta Group with 23.41%, followed by the Gamma Group with 13.98%, the Beta Group with 9.01%, and the Alpha Group with 8.93% in 2015.

PROFITABILITY AND EFFICIENCY

During 2015, the consolidated net profits of Lebanese banks grew by 7.0% to reach US$ 2.203 billion, against consolidated net profits of US$ 2.059 billion in the previous year. In fact, the rise in consolidated net profits can be attributed to a 5.7% increase in net operating income, which attained US$ 5.894 billion in 2015. The latter surpassed total operating expenses of US$ 3.243 billion, and led profits before taxes to grow by 6.9% in the past year.

It is important to note that a growth of 5.4% in net interest income alongside 2.0% in net fee and commission income contributed to the 5.7% expansion in net operating income. Out of total operating expenses, staff expenses formed the lion's share at 55.5%, and increased by 3.4% from the previous year.

RETURN RATIOS OF LEBANESE BANKS

	2014	2015	Var 15/14
Yield on earning assets	5.6%	5.7%	0.1%
o.w. in LL	6.8%	6.8%	0.0%
o.w. in FX	5.1%	5.2%	0.1%
- Cost of earning assets	3.6%	3.7%	0.1%
o.w. in LL	4.7%	4.7%	0.0%
o.w. in FX	3.1%	3.2%	0.1%
= Interest margin	2.0%	2.0%	0.0%
o.w. in LL	2.1%	2.1%	0.0%
o.w. in FX	2.0%	2.0%	0.0%
x Average interest earning assets/Average assets	95.9%	95.9%	0.0%
o.w. in LL	95.3%	95.4%	0.0%
o.w. in FX	96.1%	96.1%	0.0%
= Spread	1.9%	1.9%	0.0%
o.w. in LL	2.0%	2.0%	0.0%
o.w. in FX	1.9%	1.9%	0.0%
+ Non interest income/Average assets	1.0%	1.0%	0.0%
= Asset utilization	2.9%	2.9%	0.0%
x Net operating margin	34.3%	34.5%	0.2%
o.w. cost-to-income	51.5%	50.8%	-0.7%
o.w. credit cost	6.5%	7.0%	0.4%
o.w. other provisions	-0.1%	0.0%	0.1%
o.w. tax cost	7.7%	7.7%	0.0%
= ROAA	**1.0%**	**1.0%**	**0.0%**
x Leverage	11.1	10.9	-0.2
= ROAE	**11.0%**	**10.8%**	**-0.2%**

Source: Bankdata Financial Services wll

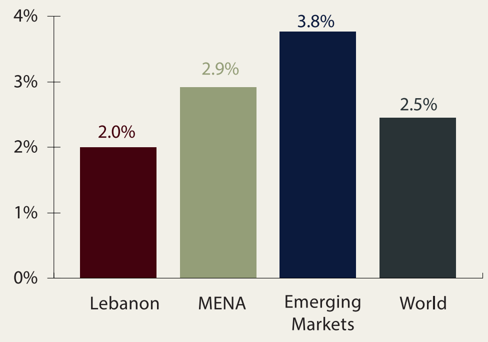
As such, the banking sector's non-interest income to total income ratio marginally contracted from 33.60% to 33.13% in 2015. The non-interest income ratio was supported by a 2.0% growth in net fee and commission income, a 25.0% improvement in net profits on foreign exchange, a 10.1% increase in net gain on financial assets and/or investments, with the ratio counterbalanced by a 14.5% contraction in other income. It is noteworthy that net fee and commission income captured the largest share of non-interest income at 48.5% in 2015, followed by net gain on financial assets and/or investments at 31.8%, net profits on foreign exchange at 11.3%, while other income formed 8.4% of the total.

PROFITABILITY OF LEBANESE BANKS' GROUPS (YEAR 2015)

	Alpha	Beta	Gamma	Delta
Spread	1.90%	1.86%	2.47%	2.68%
Interest margin	1.98%	1.96%	2.59%	2.88%
Non-interest income/total income	33.2%	30.4%	43.1%	33.8%
ROAA	1.02%	0.66%	1.53%	0.82%
ROAE	11.47%	7.68%	11.63%	3.50%

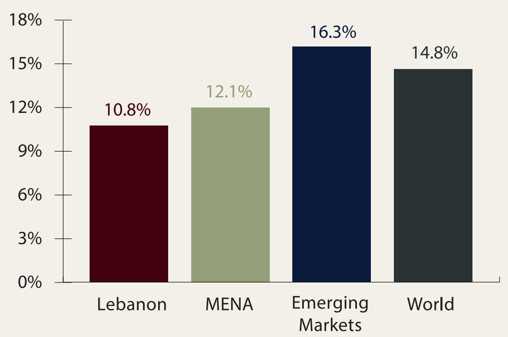
Source: Bankdata Financial Services wll

NET INTEREST MARGIN (YEAR 2015)



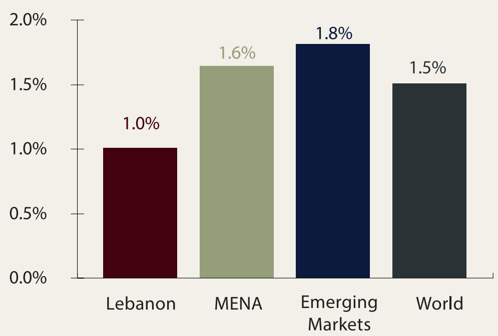
Sources: Bankdata Financial Services, IMF, Bankscope, Fitch, MENA Central Banks

RETURN ON AVERAGE EQUITY (YEAR 2015)



Sources: Bankdata Financial Services, IMF, Bankscope, Fitch, MENA Central Banks

RETURN ON AVERAGE ASSETS (YEAR 2015)



Sources: Bankdata Financial Services, IMF, Bankscope, Fitch, MENA Central Banks

The banking sector's return ratios were stable in 2015, as growth in the sector's net profits was only marginally above growth in assets and equity. The sector's return on average assets was 0.99% in 2015, unchanged from the previous year, while the return on average equity stood at 10.83% compared to 11.0% in 2014 and the return on average common equity at 11.78% compared to 12.01% in 2014. Moreover, some stability was witnessed in the sector's spread which was at 1.92% in 2015, marginally up from 1.91% in the previous year. The non-interest income to average assets slightly fell to 0.95% from 0.97%, leading to a stability in asset utilization at 2.87%, alongside a slight increase in net operating margin from 34.33% to 34.52% in 2015, while cost-to-income decreased from 51.51% to 50.81% and credit cost expanded from 6.52% to 6.96%. With a rise in some foreign bank benchmark rates most notably federal funds rates in the US, local banks took advantage of rising spreads and interest margins, widening the yields on their liquid uses, and this supported their profitability levels.

Moving on to a comparative global analysis, Lebanon's return on average assets and return on average equity ratios came short of global benchmarks. The local banking sector's return on average assets attained 1.0% in 2015, well below an average of 1.6% for the MENA region, an average of 1.8% for emerging markets and an average of 1.5% globally. At the same time, Lebanese banks' return on average equity reported 10.8% in 2015, compared to an average of 12.1% for the MENA region, an average of 16.3% for emerging markets and an average of 14.8% for the global return. As to cost-to-income, Lebanon scored 50.8%, versus 40.6% in the MENA region, 51.6% in emerging markets and 53.0% at the global level.

MANAGEMENT EFFICIENCY OF LEBANESE BANKS

	2010	2011	2012	2013	2014	2015	Var 15/14
Cost per average branch (US$ million)	1.87	1.89	2.01	2.10	2.18	2.21	1.3%
Staff expenses per average staff (US$ 000s)	42.2	43.0	45.6	48.8	51.3	50.9	-0.4%
Staff expenses to general operating expenses (%)	54.0%	55.6%	54.6%	55.6%	56.4%	55.5%	-0.9%
Cost-to-income (%)	48.2%	49.7%	49.7%	51.8%	51.5%	50.8%	-0.7%
Cost-to-average assets (%)	1.52%	1.46%	1.51%	1.50%	1.48%	1.46%	-0.02%

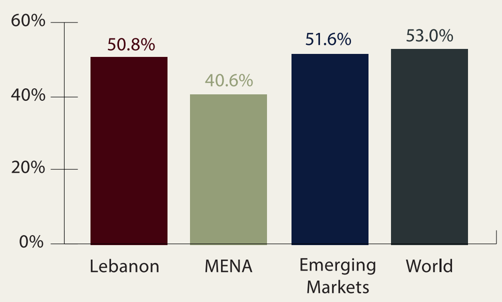
Source: Bankdata Financial Services wll

MANAGEMENT EFFICIENCY OF LEBANESE BANKS' GROUPS (YEAR 2015)

	Alpha	Beta	Gamma	Delta
Cost per average branch (US$ million)	2.28	1.67	1.69	3.28
Staff expenses per average staff (US$ 000s)	51.3	45.5	46.2	58.7
Staff expenses to general operating expenses (%)	55.7%	52.6%	58.1%	59.0%
Cost-to-income (%)	48.9%	66.9%	56.9%	69.2%
Cost-to-average assets (%)	1.39%	1.79%	2.47%	2.80%

Source: Bankdata Financial Services wll

COST-TO-INCOME (YEAR 2015)



Sources: Bankdata Financial Services, IMF, Bankscope, Fitch, MENA Central Banks

Regarding the profitability of banks by group, Alpha and Gamma banks reported profit growth rates of 8.3% and 152.5% respectively, while Beta and Delta banks witnessed respective declines of 9.2% and 26.7% in their bottom lines in 2015. With regards to return ratios, they seem to be almost positively correlated with the size of banks, with the return on average common equity registering the highest ratio of 12.76% for Alpha banks, followed by 11.63% for Gamma banks, 7.70% for Beta banks and 3.51% for Delta banks in 2015. Also, interest margin reported a low of 1.96% for Beta banks, followed by 1.98% for Alpha banks, 2.59% for Gamma banks and 2.88% for Delta banks. The share of non-interest income to total income reported 30.36% for Beta banks, 33.24% for Alpha banks, 33.80% for Delta banks, and 43.09% for Gamma banks.

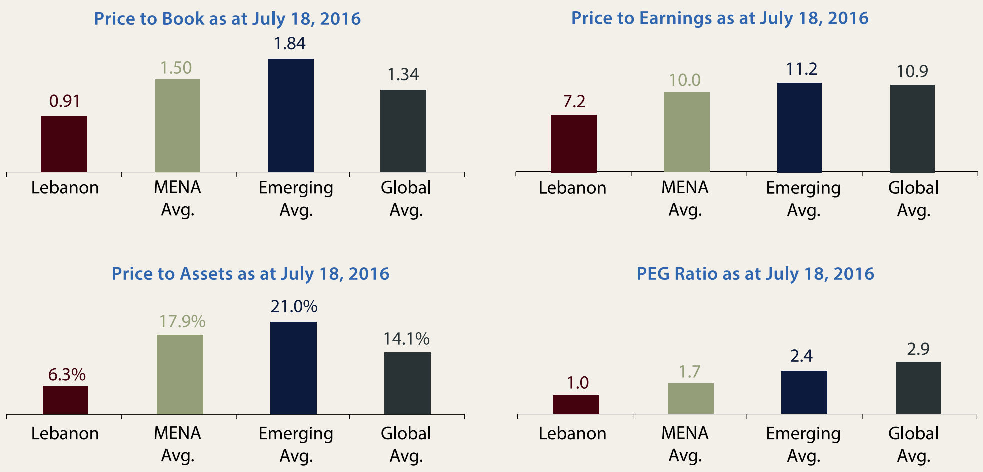
Last but not least, larger banks proved to be more efficient due to the economies of scale and strong organizational structures, with the cost-to-income ratio of Alpha banks at 48.86%, followed by Gamma banks with 56.91%, Beta banks with 66.85%, and Delta banks with 69.18%. Parallel to the cost-to-income ratio, the cost-to-average assets fell as the size of banks increased. Banks in the Alpha group posted the lowest ratio of 1.39%, followed by the Beta Group with 1.79%, the Gamma Group with 2.47% and the Delta Group with 2.80% in 2015.

INVESTMENT CONSIDERATIONS

With Lebanese banks realizing a 7.0% growth in consolidated net profits during 2015 despite tough operating conditions domestically and in main countries of presence, earning per share measures rose as well. Common earnings per share reported a 13.9% increase last year, moving from LL 548.73 in 2014 to LL 625.22 in 2015. Likewise, banks partly incorporated new earnings generated into their capital base and also looked to increase their shareholders' equity in the aim of boosting their capitalization ratios and further building shields to potential pressures on their capital base. As a result, the common book per share of the Lebanese banking sector increased by 14.6% on a yearly basis, from LL 4,679.38 to LL 5,362.20 over the covered period.

Yet while fundamentals are still on the rise, banking stocks listed on the domestic bourse, remain plagued by a chronic lack of liquidity and turnover. This is due to the persisting political bickering and status quo adding to fears of spillovers from the regional turmoil. The BSE trading value retreated last year to less

COMPARATIVE STOCK MARKET PRICING RATIOS



Sources: Bloomberg, Citigroup, IMF, Beirut Stock Exchange, Bank Audi's Group Research Department than half a billion US dollars annually, leading the turnover ratio to contract to a mere 4.7%, which is very low by regional and global standards.

As such, Lebanese banks' management strived to compensate shareholders for the relative lack of liquidity on the domestic equity market, and increased the dividend distribution last year, which is also in line with the rise in banks' bottom lines. Common dividends rose by 12.4% and also triggered a double-digit rise in common dividends per share to LL 204.39 in 2015. As a result, the common payout ratio inched up to cross again the 30% threshold and reach 30.93%, which is pretty much in line with international averages.

Bearing in mind the slight decline in the overall BSE price index last year in a sluggish trading mode, and the rising dividends distributed by banks, the dividend yield measure remains an enticing offsetting factor to low banking stock liquidity. As a matter of fact, the average dividend yield of large banks listed on the BSE (both common and preferred shares) reached 6.2% when computing it with 2015 dividends. This compares to lower regional and emerging market averages of 3.8% each and a global average of 2.6%.

Apart from attractive dividend yields, Lebanese banking stocks also boast enticing valuation ratios, given their healthy fundamentals and constrained share turnover. The large listed Lebanese banks' market capitalization-weighted P/E ratio actually stands at a relatively low 7.2x (latest available prices during the day of July 18, 2016), comparing to a MENA average of 10.0x, an emerging markets average of 11.2x and a global average of 10.9x. With a similar methodology, large listed Lebanese banks traded on average below their book value per share, with a P/BV ratio of 0.91x, against regional and broader international averages in the 1.3x-1.8x range.

The price to assets ratio on average was at a low 6.3%, against benchmarks in the 14%-21% range abroad. Last but not least, among market pricing metrics, the PEG ratio, measured as the P/E to the earnings per common share growth of large listed banking stocks over the past seven years, reached 1.04x, trading at a discount of 39% to the MENA average, of 57% to emerging markets average and of 64% to the global average. The healthy fundamentals of Lebanese banks, coupled with their attractive price multiples and dividend yields, augurs well for the longer run when domestic and regional conditions improve.

CONCLUSION

While Lebanon's consolidated banking activity slowed down in 2015, its growth remains sound on the overall, hovering around the mid single-digit levels. Lebanese banks were able to maintain positive activity growth domestically and abroad despite the tough operating environment characterizing their operating conditions in Lebanon and in foreign markets of presence.

More importantly, Lebanese banks were able to maintain their rigorous risk profile within the context of persistently conservative banking practices amid an environment of strict regulation and supervision. Such a risk conscious banking profile allowed them to adequately address the rising challenges raised by the tough operating environment, marking a new phase of resilience and extending the paradox of "sustainability amid uncertainties" that has characterized their activity over the past decades. Their strong liquidity, adequate capitalization, good asset quality and appropriate provisioning, as outlined throughout this report, lie at the heart of their conservative management philosophies.

At the profitability level, while a number of foreign markets have increasingly contributed to consolidated profitability, Lebanese banks were able to report decent domestic profit growth in 2015. The modest quantity-effect ensured by the expansion of the lending portfolio somewhat offset the still tight interest rate margins and allowed banks to post healthy profit growth, yet bearing in mind that banks' return ratios remain squeezed with the annualized return on equity remaining below their cost of equity at large. The efficiency enhancement efforts on behalf of Lebanese banks in a period of tough operating conditions in Lebanon and major countries of presence provided a relative support to profitability over the past year.

Looking ahead, an analysis of strengths and weaknesses is important to assess Lebanese banks prospects. At the level of strengths, we mention the appropriate regulation and supervision, helping banks to maintain much-needed confidence and sustain a large and resilient customer base. Solid liquidity buffers and depositor-based funding will continue to support system stability. In parallel, banks can absorb the rising cost of risk in private-sector lending amid sound risk coverage and conservative management practices. At the level of weaknesses, we mention that banks bear high exposure to the sovereign, which is the main risk factor for the domestic banking system, although such an exposure has declined in relative terms over the past decade. Also, Lebanese banks operate in an environment that is considerably vulnerable to internal and external political risk.

Having said that, while weaknesses and risks are real, strengths and opportunities outpace potential threats at the horizon. On the basis of universal banking profiles and wide cross-border presence, Lebanese banks are apt to adequately benefit from a trend reversal in the operating environment in due time when current transitory challenges gradually dissipate looking ahead. In the mean time, Lebanese banks are persistently keen to adopt internal procedures that comply with best international practices, particularly in terms of risk management systems, compliance and corporate governance at large.

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